

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

ATLAS COMMUNICATIONS, LTD.	:	CIVIL ACTION
	:	
v.	:	
	:	
LYMAN E. WADDILL and INTEGRITY	:	
TELECOM, INC.	:	No. 97-1373

MEMORANDUM AND ORDER

Norma L. Shapiro J.

October 31, 1997

This breach of contract action was brought by Atlas Communications Ltd. ("Atlas") against Integrity Telecom, Inc. ("Integrity") and its principal agent, Lyman E. Waddill ("Waddill"). Jurisdiction is conferred by 28 U.S.C. §1332. At the commencement of this action, Atlas was incorporated in Pennsylvania and defendants Waddill and Integrity were citizens of California. Plaintiff's alleged damages are in excess of \$75,000.

On March 21, 1997, Atlas filed a motion for default against defendant Integrity. This motion was granted, pursuant to Fed. R. Civ. P. 55(a), by order of March 21, 1997. On July 30, 1997, defendant Integrity filed a motion under Fed. R. Civ. P. 55(c) to set aside the default because mistake and excusable neglect caused delay in answering the complaint. Upon consideration of defendant Integrity's motion to set aside the default, and plaintiff's opposition thereto, the court will conditionally deny defendant Integrity's motion to set aside the default, subject to reconsideration if Integrity submits evidence of a meritorious defense within twenty days.

BACKGROUND

Atlas is a telephone company dealing primarily in domestic long-distance service provided to customers that resell the service. Atlas provides some international service if it is a small portion of the reseller's overall need. Integrity specializes in servicing companies selling prepaid debit card service to long-distance telephone users. Atlas alleges that in mid-December, 1996, Integrity's agents contracted to purchase long-distance phone service from Atlas to resell to its customers as a result of Integrity's financial problems with its original supplier. In February, 1997, a dispute arose over the amount of money Integrity owed Atlas. Atlas terminated service on February 12, 1997.

On February 24, 1997, Atlas filed this action against Integrity and its principal agents, Paul Dugan and Lyman E. Waddill. On February 27, 1997, Atlas, seeking a prejudgment writ of attachment against Integrity, filed an action in California state court. After a hearing the following day, the California court granted Atlas's request for a temporary restraining order, precluding Integrity from transferring its interest in any of its bank accounts, accounts receivable, or telecommunications equipment. At that hearing, John Vaught ("Vaught"), counsel for Integrity, was handed a copy of the summons and complaint in this action. The parties dispute whether this constituted valid service. No response having been filed, the court entered a default against Integrity on March 21, 1997. On April 1, 1997,

Atlas served Integrity with another copy of the complaint and summons. On July 30, 1997, Integrity filed a motion to set aside the default.

DISCUSSION

It is in the court's discretion to decide if entry of default is proper. A default is not favored and doubt should be resolved in favor of setting aside the default and reaching a decision on the merits. Gross v. Stereo Component Systems, Inc., 700 F.2d 120, 122 (3d Cir. 1983), citing Farnese v. Baqnasco, 687 F.2d 761, 764 (3d Cir. 1982).

Under Fed. R. Civ. P. 55(c), a court may set aside a default "[f]or good cause." The court must consider: (1) whether lifting the default would prejudice the plaintiff; (2) whether the defendant has a prima facie meritorious defense; (3) whether the defaulting defendant's conduct is excusable or culpable; and (4) whether alternative sanctions would be effective. Emcasco Ins., Co., v. Sambrick, 834 F.2d 71, 73 (3d Cir. 1987); \$55,518.05 in U.S. Currency, 728 F.2d 192 (3d Cir. 1984); Feliciano v. Reliant Tooling Co., 691 F.2d 653, 656 (3d Cir. 1982); Spurio v. Choice Sec. Sys., Inc., 880 F. Supp 402, 404 (E.D. Pa. 1995).

1. Prejudice to the Plaintiff

The court must first consider whether vacating the default would prejudice plaintiff's case. Prejudice can be shown through loss or destruction of evidence, increased potential for fraud and collusion, or substantial reliance upon the entry of default. Feliciano, 691 F.2d at 657; Gross, 700 F.2d at 123. In its

opposition to the present motion, Atlas has not argued that it would be prejudiced if the court were to set aside the default. Atlas argued that despite the attachment it obtained in California, Integrity has "consumed, transferred, and encumbered" its assets. (Atlas's Memorandum of Law Supporting Atlas's Opposition to Integrity's Motion to Set Aside Default, p. 8). If Atlas is correct that Integrity has violated the California court order by ignoring or avoiding the attachment, Atlas may seek a remedy from that court. Prejudice to the plaintiff if the default were set aside has not been demonstrated.

2. Defendant's Conduct

In evaluating whether defendant's conduct is culpable, the court must decide if defendant's actions were caused by mistake or excusable neglect. See, Feliciano, 691 F.2d at 656.

"Appropriate application of the culpable conduct standard requires that as a threshold matter more than mere negligence be demonstrated." Hritz, 732 F.2d at 1183. Wilfulness or bad faith is required.

Integrity makes two arguments: 1) it was not served until April 1, 1997, ten days after the entry of the default; and 2) as a result of the California court attachment, it had no funds to retain local counsel. A default "entered when there has been no proper service of the complaint is, a fortiori, void, and should be set aside." Gold Kist, Inc. v. Laurinburg Oil Co., Inc., 756 F.2d 14, 19 (3d Cir. 1985). If Integrity were not served until after the entry of default, the default must be set aside.

Because excusable neglect has been shown even if Integrity were served on February 28, the court need not reach the issue of whether that service was valid.

The court requires local counsel in every action before this court. Integrity alleges "every local counsel contacted requested a retainer," (Declaration of Jon Vaught in Support of Motion to Set Aside Default, ¶ 12) so it was unable to file an appearance until July 30, 1997. Integrity should have contacted the court regarding the delay in finding local counsel, but its failure to do so cannot be characterized as "flagrant bad faith" or "callous disregard of [its] responsibilities." National Hockey League v. Metro. Hockey Club, Inc., 427 U.S. 639, 643 (1976). In light of the policy that "[d]ismissal must be a sanction of last, not first, resort," Carter v. Albert Einstein Medical Center, 804 F. 805, 807 (3d Cir.1986) (quotations omitted), defendant's actions are sufficiently excusable to vacate a default not yet reduced to judgment.

3. Defendant's Prima Facie Meritorious Defense

"The showing of a meritorious defense is accomplished when allegations of defendant's answer, if established at trial would constitute a complete defense." Hritz v. Woma Corp., 732 F.2d 1178, 1181 (3d Cir. 1984). While several district courts have vacated entries of default on the showing of a partial defense, see Grubb v. Evangelisti, 1989 WL 55382, at *1 (E.D. Pa. May 23, 1989); Howard Fischer Associates, Inc. v. CDA Investment Technologies, 1995 WL 472115 (E.D. Pa. Aug. 10, 1995), the Court

of Appeals has always described this element as requiring a "complete defense." See, e.g., United States v. \$55,518.05 in U.S. Currency, 728 F.2d 192, 195 (3d Cir. 1984); Gross v. Stereo Component Systems, Inc., 700 F.2d 120, 122 (3d Cir. 1983); Tozer v. Charles A. Krause Milling Co., 189 F.2d 242, 244 (3d Cir. 1951). Whether Integrity has a complete defense is a critical issue because without a meritorious defense Integrity could not prevail at trial. \$55,518.05 in U.S. Currency, 728 F.2d at 195 ("[T]here would be no point in setting aside the default judgment . . . if [the defendant] could not demonstrate the possibility of . . . winning."). The purpose of requiring a complete defense, which some have described as a "threshold issue," Estrada-Torres v. Remos Mushroom Services, 1997 WL 364496, *1 (E.D. Pa. June 25, 1997), is to protect an innocent defendant who may ultimately prevail.

In its motion, Integrity does not assert a complete defense; it alleges only a partial defense. Integrity's defense is based on "serious questions as to the amounts that Integrity actually owes Atlas." (Integrity's Memorandum of Law in Support of Motion to Set Aside Default, P. 9). Integrity argues that the Atlas claim includes amounts unrelated to Integrity business. This does not justify setting aside the default because the amount of the judgment will be determined only after an evidentiary hearing. Fed. R. Civ. P. 55(b)(2). Integrity's partial defense is relevant to damages, rather than liability.

Integrity has failed to allege a complete defense.

4. Alternative Sanctions

The Court of Appeals has directed district courts to consider "the effectiveness of alternative sanctions" in determining whether to set aside an entry of default. Emasco, 834 F.2d at 73. In a recent case in which defendant failed to make a showing of a meritorious defense, Judge Van Antwerpen noted that "courts in this circuit seem unwilling to deny the motion to set aside entry of default solely on the basis that no meritorious defense exists." Mike Rosen & Assocs., P.C., v. Omega builders, Ltd., 940 F. Supp. 115, 121. Instead, the court granted the defendant's motion to set aside the default, subject to the alternative sanction that defendant resubmit facts supporting a complete defense within a specified period. Id. This court will apply a similar procedure, and will conditionally deny defendants' motion to set aside the default, subject to reconsideration if Integrity presents facts constituting a complete defense within twenty days. If Integrity fails to do so, the default will stand, but no default judgment will be entered until there has been an evidentiary hearing to establish the amount of the judgment; counsel for Integrity will have the opportunity to challenge the amount allegedly due Atlas.

Conclusion

Integrity has satisfied two prerequisites for setting aside a default: lack of prejudice to the plaintiff, and lack of culpable conduct on its part. Integrity has failed to allege a complete defense. Integrity's allegation of a partial defense is

insufficient to justify setting aside the entry of default on liability. The court will deny Integrity's motion subject to reconsideration if it presents prima facie evidence of a complete defense within twenty days.

For the reasons stated in this opinion, the defendant's motion to set aside the default will be conditionally denied. An appropriate order follows.

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TELECOM, INC.	:	No. 97-1373

ORDER

AND NOW, this 31st day of October, 1997, upon consideration of defendant Integrity Telecom, Inc.'s ("Integrity") motion to set aside the default, plaintiff's opposition thereto, it is **ORDERED** that:

1. Defendant Integrity's motion to set aside the default is **DENIED**;

2. The entry of default against defendant, Integrity will be set aside, if Integrity presents prima facie evidence of a complete defense within twenty days.

Norma L. Shapiro J.